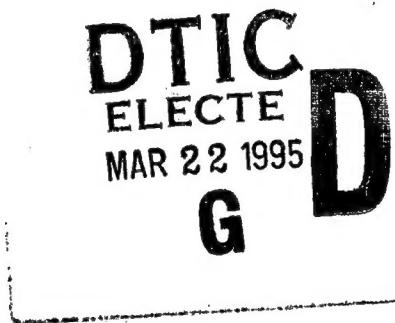


Logistics Management Institute

Establishing Effective Management
Controls for the Defense Personnel
Support Center's Mail Service
Pharmacy Demonstration Project

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June 1994

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ESTABLISHING EFFECTIVE MANAGEMENT CONTROLS FOR THE DEFENSE PERSONNEL SUPPORT CENTER'S MAIL SERVICE PHARMACY DEMONSTRATION PROJECT

INTRODUCTION

In the FY93 Defense Appropriations Act, Congress directed DoD to set up a demonstration project within 18 months to evaluate the use of the mail to provide maintenance-dose pharmaceuticals to eligible beneficiaries. The Act identified eligible beneficiaries as active duty dependents, retirees, retiree dependents, and individuals in specific areas who were affected by base closings. The act further specified that the area covered by the demonstration project had to include at least two regions with at least two states in each region. Congress' goal for the demonstration project was to test customer acceptance of mail service pharmacy and the concept's potential ability to reduce health care costs and military staffing requirements.

Although new to DoD, the concept of mail service pharmacy has existed for some time. Companies such as General Electric and General Motors provide their employees pharmaceuticals through the mail as one component of their total employee health care program. In the public sector, the Department of Veterans Affairs (VA) has had a mail service program for many years and is now expanding the scope of its distribution program and centralizing it. The Public Health Service also has a limited program that mails pharmaceuticals to remotely located Native American customers.

To comply with Congress' mandate, DoD is now establishing several mail service pharmacy (MSP) demonstration projects. The Defense Personnel Support Center's (DPSC) program will serve eligible customers in Pennsylvania, New Jersey, Delaware, South Carolina, Georgia, and Florida. It expects to fill 2 million prescriptions annually. Other DoD demonstration programs will use the VA and private-sector firms as mail service providers.

Because of congressional interest and because it believes mail service pharmacy may become an important part of the total mix of services that it offers in the future, DPSC wants to ensure that its demonstration project is effectively managed. It seeks specific recommendations for managing its program in the following areas:

- ◆ Validation of customer eligibility
- ◆ Certification of contractor billing

- ◆ Monitoring of customer satisfaction
- ◆ Prevention of the diversion of product, bought at government prices, to commercial customers.

This report recommends the actions that DPSC should take now to establish management controls for both its demonstration project and a DoD-wide program if it expands later. Our recommendations also address actions that DPSC should take in future contracts that we believe will further reduce the cost of mail service pharmacy.

In developing our recommendations, we conducted extensive interviews with private-sector firms, drug manufacturers, mail service pharmacies, other government agency mail service providers, and government and private-sector auditors. By talking with private-sector firms such as UNISYS and Chrysler, we learned how those companies manage their mail service contracts. From discussions with mail service providers and pharmaceutical manufacturers, we gained an understanding of industry practices. From government and private-sector auditors who specialize in health care issues, we identified the management controls that they think are appropriate and the auditing tools that they use to conduct their audits.

Our discussions with industry indicate that DPSC's management concerns are much the same as those of the private sector. Each company we contacted, for instance, used some means to ensure that its mail service provider checked the eligibility and satisfaction of its customers. All of the companies that we talked to agreed that contractor bills needed to be audited, although not all had programs in place to do so. Companies without audit programs cited the newness of their mail service program or its relatively small size as the reason for not acting sooner. Companies that were performing audits most often used auditing firms with experience in the health care industry. Although we found no one in the private sector that audited to prevent inventory diversion, we discovered that diversion is a major concern of pharmaceutical manufacturers because it reduces their profits. We also discovered that manufacturers are actively seeking ways to prevent diversion in the future. Thus, we concluded that DPSC's efforts to prevent diversion now are a precursor of actions that the private sector will take in the future.

The remainder of this report provides our recommendations for the management actions that DPSC should take to properly set up and run its mail service demonstration project. Within the context of each of our recommendations, we discuss pertinent private-sector and other government agency practices.

RECOMMENDATIONS

1. *DPSC should arrange for The Defense Enrollment Eligibility Reporting System (DEERS) to provide an automated tape of eligible DoD customers to the contractor on a scheduled basis.*

Each of the private-sector companies we interviewed indicated that they provide their mail service contractor with automated eligibility data. The contractors used those data with their own software to verify customer eligibility. Nearly all of the companies we talked with provide the data on tape (see Table 1). General Motors is the one exception; its mail service contractor has a direct line into GM's eligibility files for real-time, computer-to-computer validation of eligibility.

Table 1.
Company Profile Table

Company							
Description	Air Products	Chrysler	Ford Motor	General Electric	General Motors	HIP Rutgers	UNISYS
Audit for diversion?	No	No	No	No	No but considering	No	No
How often are eligibility files updated	Monthly, moving to weekly	Monthly	Monthly	Monthly, moving to weekly	On-line	Monthly	Bi-weekly
How are updates provided to contractor	Tape, plan for EDI 834 transaction	Tape	Tape	Tape	On-line	Tape via Baxter Caremark	Tape
Method for verifying invoices	Not done yet	Use outside auditor	Use John Hancock	Not done yet	Not done yet	Use Baxter Caremark	In-house audit
How is customer satisfaction determined	Survey	Not done yet, but will survey	Monitor UAW complaints	Survey monthly	Not done yet but will survey	Not done yet	Survey
Level of satisfaction	High	High	High & improving	Very high	High	Good	High & improving
How does contractor provide reports	Paper & digital	Paper	Paper	Paper	On-line	Paper & digital	Mostly digital
Frequency of reports	Biweekly	Monthly	Weekly	Request	On-line	Monthly	Monthly

Note: EDI = Electronic Data Interchange; UAW = United Auto Workers.

Although the DEERS data base of DoD eligible personnel changes constantly, its rate of change does not appear to be high enough to warrant DPSC providing its contractor with on-line, computer-to-computer access. It is clear, however, that DPSC must provide its contractor with an efficient way of processing the 2 million prescriptions it expects per year if it is to keep contract costs as low as possible. A paper printout or even a microfiche copy of the DEERS data base would be unwieldy, and using it to check eligibility would take too long. A DEERS terminal at the contractor's site from which the contractor could query eligibility would be faster, but it would be labor intensive and still far too slow. DPSC's contractor will have its own verification software and can use that software efficiently to confirm eligibility if DPSC provides it the data to do so. A tape from the DEERS system is the most cost efficient means to provide those data.

2. *DPSC should conduct its own independent surveys to evaluate customer opinions about mail service pharmacy, their attitudes about service quality, and their desires for additional services.*

Several companies described or showed us their mail service provider's performance reports which provide an extensive analysis of service levels. DPSC can use similar reports to monitor its contractor's performance. However, DPSC also needs information to evaluate customer attitudes about its demonstration effort at first and later to market a DoD-wide mail service pharmacy program effectively. The contractor or contractors that DPSC selects will be able to provide some assistance in surveying customers, but we recommend that DPSC also have its own capability for independently surveying actual or eligible customers to determine issues such as

- ◆ where they filled prescriptions for pharmaceuticals in the past,
- ◆ how well the mail service demonstration program has served them,
- ◆ how the mail service pharmaceutical program compares to previous methods they used, and
- ◆ what they would like to see the program provide in the future.

We also recommend that DPSC work with the Medical Functional Information Management (MFIM) team of the Office of the Assistant Secretary of Defense (Health Affairs) when designing its surveys. MFIM is an advocate of the mail service pharmaceutical program. By law, it must provide Congress a report on the effectiveness of mail service pharmacy demonstration efforts. It is in DPSC's and MFIM's mutual best interest to acquire the information both groups need to evaluate this program and to make it a success.

When it surveys actual mail service pharmacy users or those who are eligible to use the service but have not, DPSC will send questionnaires to several thousand randomly selected individuals. In most cases, it will have its mail service contractor conduct the survey. Regardless of who does the survey, we recommend that DPSC use auditing support software to ensure that it achieves statistically valid results. We describe that software in Recommendation 4.

We further recommend that DPSC use survey forms that employ optical mark recognition (OMR) to process completed surveys efficiently. OMR allows those taking a survey to answer questions by darkening the appropriate circle next to each question with a pencil or pen. The advantage to using OMR is that completed forms can be quickly and accurately scanned into a computer without additional key entry. OMR scanners cost approximately \$7,000. Survey software that runs on a personal computer and processes data entered through an OMR scanner costs approximately \$600.

3. *DPSC should use an organization with experience in the health care industry to audit its contractor.*

Several accounting firms as well as the General Accounting Office (GAO) told us that auditing the health care industry is a specialty. It is so much of a specialty that several large accounting firms are forming their own separate divisions just to audit health care. Deloitte Touche, a Big-6 public accounting firm, for instance, described to us several examples of fraudulent practices that it contends auditors without a background in health care might easily overlook. National Prescription Administrators (NPA), Chrysler's retail pharmacy auditor, made the same point. NPA prescreens 100 percent of Chrysler's prescription data electronically against a 26-category profile of problems it has identified from past experience. By comparing a particular pharmacy against that profile, it can select specific areas for an on-site audit and know what to look for ahead of time. Problems it frequently finds include

- ◆ billing for average wholesale price instead of a lower contractual price,
- ◆ issuing brand name pharmaceuticals when less expensive, therapeutically equivalent generic products exist,
- ◆ invoicing for items not dispensed, and
- ◆ dispensing the right product but in smaller quantities than billed.

NPA indicates it finds significant error levels by knowing where to look and that it typically saves its clients 10 – 25 percent in overpayments.

When its program is fully functional, DPSC estimates that its contractor will receive 2 million prescriptions per year. The contractor will bill DPSC for each prescription that it fills, each intervention that it performs, and all inventory that it buys from nondepot sources. DPSC will not see — nor would it be practical for it to see — all of the source documents that support a contractor's bill. Thus, DPSC must statistically sample contractor bills and their source documents to verify that the contractor is billing properly.

Two actions are critical to the success of that type of audit. The auditing activity must know how to sample and it must know what to sample. How to sample is determined by the rules of statistics, which the auditing activity must follow to achieve an accurate result. We discuss this requirement further in Recommendation 4. What to sample is determined by the auditor's past experience with problem areas.

DPSC basically has two alternatives for auditing its contractor; i.e., a private-sector accounting firm or the Defense Contract Management Command (DCMC). Because audit experience in the health care industry is so necessary to the conduct of an effective audit, we recommend DPSC use a private-sector firm with that experience. While DCMC has a lot of auditing experience and would minimize DPSC's contract administration costs, we do not recommend its use. It has

little or no experience auditing the health care industry and none of that experience is in mail service pharmacy operations. Alternatively, we recommend DPSC work with DCMD to conduct its audits but subcontract those audits to a private-sector firm with the necessary experience.

We attempted to determine the possible cost of using a private-sector auditor. Not surprisingly, we found that that cost would vary significantly by the amount of effort that DPSC required. Based on conversations with several private sector firms, we estimate a statistical evaluation of the contractor's billing system and the accuracy of its invoices would probably cost between \$50,000 – \$80,000 per audit.

4. *DPSC should provide its Contracting Officer's Technical Representative (COTR) with audit support software to help monitor contractor operations.*

Just as experience is necessary to effectively audit contractor operations, the right tools are also important to ensure that audit samples produce valid results. DPSC estimates that its contractor will receive 2 million prescriptions annually, and it will retain a third party to audit its contractor's fulfillment of those prescriptions. Since its COTR will oversee that entire process, DPSC should provide that individual with the proper tools to effectively perform the function.

We examined the software tools that auditors in the private and public sectors use to support their health care audits. We found that several of the Big-6 accounting firms are developing their own proprietary software but that many others, including the GAO, use commercially available general audit support software. These packages provide a wide range of auditing tools among which are the means to perform various types of sampling including systematic, random, and dollar unit samples. They include report writers that summarize data in multiple ways such as by date, account number, or social security number, and they identify gaps and duplicate numbers in sequentially numbered document series and handle large volumes of data.

Working through the American Institute of Certified Public Accounts, we found two commercially available audit support packages in common use. Audit Command Language (ACL) is produced by ACL Services, Ltd., of Vancouver, British Columbia, costs approximately \$2,000, and is used by more than 10,000 customers worldwide. Several Federal agencies including the Departments of Education and Air Force use ACL. Interactive Data Extraction and Analysis (IDEA) is produced by the Canadian Institute of Chartered Accountants of Ottawa, Ontario, costs \$1,200, and has more than 5,000 users. The American Institute of Certified Public Accountants (AICPA) endorses IDEA, and the General Services Administration, GAO, and the Internal Revenue Service use it. Both software packages run on IBM compatible computers. ACL is available in DOS and Windows versions. IDEA is available in DOS and will be available in a Windows version by the end of 1994. Of the two packages, ACL seems to be faster, but IDEA seems to be more user friendly. For that reason, we found many activities use both packages so that they can take advantage of the best features of each.

The GAO believes that IDEA allows its auditors to perform a better audit and to improve their evaluations. We think DPSC's COTR will similarly benefit, and it is this capability in the hands of the COTR that we referred to in Recommendation 2 for conducting independent customer surveys. As an additional benefit, GAO told us during our January 1994 visit that it would train DPSC's COTR in the use of IDEA.

5. *As a condition of contract award and annually thereafter, DPSC should require the contractor's independent auditor to certify that its inventory control system has prevented diversion of inventory from occurring in the past and will do so in the future.*

Under the terms of the DPSC mail service pharmacy contract, DPSC's contractor will be able to purchase inventory from government sources such as depots and Federal Supply Schedules but will only be able to use that inventory to support DoD customers. Since the costs of items from these sources will be significantly below those that the contractor could find elsewhere in many cases, the contractor could have a substantial incentive to earn more profit by diverting that inventory to the support of its commercial customers. That action, however, would decrease the profits of pharmaceutical manufacturers, and if DPSC were to tolerate it, it would potentially jeopardize the discounts that DoD now receives from manufacturers.

The DPSC has addressed the diversion concerns of pharmaceutical manufacturers in two ways. In its original solicitation, DPSC required each mail service pharmacy offerer to describe how its inventory control system would prevent diversion. Based on our interim recommendations from this study, DPSC subsequently amended its solicitation to require its contractor to have its independent accounting firm certify annually that its inventory control system had not, and would not, allow diversion to occur.

We evaluated a representative sample of five diversion control plans from offerors that DPSC's contracting officer provided to us and concluded that each represented an effective deterrent to diversion when used in conjunction with an independent auditor's nondiversion certification.

All of the diversion control plans we examined had several things in common. Each plan

- ◆ tracked the on-hand quantities of items in stock,
- ◆ recorded the quantity of each drug issued and the beneficiary who received that issue,
- ◆ tracked the on-order amount, source of supply, and cost of each replenishment,
- ◆ maintained historical records of each transaction that affected inventory for audit purposes, and

- ◆ conducted physical inventories to reconcile computer on-hand quantities with actual on-hand quantities at least annually and more often when required.

The five plans that we examined proposed to handle inventory physically in one of three ways. Two would physically segregate inventory bought from government and commercial sources. One of those two would use separate storage locations in the same production facility while the second would set up a completely independent company to serve DoD. Two other plans proposed physically commingling inventory bought from government and commercial sources, but would use the computer to track the on-hand quantities of each. One of those two proposed using separate numbers for the same inventory bought from government and nongovernment sources. The second would use a separate data base to track items that were procured from government sources. The net operating result of these four plans was the same. If the computer did not have sufficient on-hand assets to fulfill a commercial customer's requirement, it would display a zero balance even though inventory bought from government sources might well exist in the same location.

The fifth plan that we examined would commingle inventories but would pay no attention to the source of the items in inventory. Instead, it would track the quantities of items dispensed to DoD customers and use those data to replenish its inventory from a government source when that source was cost-effective.

One of the five plans also proposed that a shortage in the commingled inventory of a particular item be changed to the balance of that item that was bought from nongovernment sources. Such a proposal would appear to greatly simplify a diversion audit. By definition, the on-hand quantity of an item purchased from government sources should equal its beginning inventory plus its receipts minus its issues. As long as the total on-hand quantity of that item, regardless of source, was greater than the beginning government source inventory plus government source receipts minus government issues, government source inventories would be present and diversion by definition would not have occurred.

After examining each of the five diversion control plans, we concluded that they all generated sufficient information to allow an auditor to find diversion if it occurred. Since the contractor will be required to have its independent auditor issue an annual nondiversion certification, and that certification will require an audit, we concluded that sufficient measures will exist to prevent diversion.

RECOMMENDATIONS FOR FUTURE CONTRACTS

6. *DPSC should evaluate the use of capitated rates and risk-sharing provisions in its future mail service contracts as a means of continually reducing future contract costs.*

The current DPSC mail service contract will produce data on costs, customers, and usage patterns that DoD has previously not had available and will create a powerful dynamic for reducing mail service pharmacy costs in the future. Our evaluation of trends in the health care industry indicates a likely move toward the use of risk-sharing partnerships between health care organizations and their distributors. In such partnerships, the distributor shares in cost savings that result from the actions of either party to control costs. The partnerships are called risk sharing, however, because both partners also share in any cost overruns.

We found two examples of capitated rate contracts — one current and one imminent. At the Uniformed Services Treatment Facility in Baltimore, the contractor that operates the outpatient pharmacy is reimbursed a flat monthly rate based on the number of patients, their age and their sex. In East Providence, R.I. Claflin Co. Inc., was on the verge of signing a six-year capitated purchasing agreement with a mid-sized community hospital when we prepared this report. Under that agreement, Claflin will receive a fixed fee per patient regardless of the items used. Both parties will share supply cost savings when they occur and cover cost overruns if necessary.

With data from its demonstration project and the information that the MFIM will generate on all mail service pharmacy efforts, we think DPSC will be able to attract bids for a risk-sharing/capitated rate partnership with its contractors in the future. Since contractors will receive the same amount for each mail service action and will only increase their profits by reducing costs, they will have a strong incentive to take actions in conjunction with DPSC that will reduce costs. The resultant savings will benefit taxpayers, DoD, DPSC, and contractors.

In such a partnership, contract provisions that direct the contractor to buy from specific sources or to document when it does not do so will no longer be necessary. The contractor will naturally seek the lowest cost source because that action will increase its profits. When DPSC eliminates source-decision documentation, it will reduce the contractor's administrative costs and thus the likely cost of future contracts.

7. *DPSC should allow contractor pharmacists to intervene with prescribing doctors and should use the tri-service formulary now being developed by the Army's Pharmaco-Economic Center in San Antonio, Tex., as the basis for that intervention.*

In future contracts, we recommend DPSC allow the contractor's pharmacists to intervene with prescribing doctors. MEDCO Containment Services, Inc., the largest mail service provider in the United States, claims its pharmacists are able to convince doctors to change their prescriptions to less expensive, therapeutically equivalent medications 40 percent of the time. When future contracts allow

intervention, they should specify the use of the Army-developed tri-service formulary. That action will reduce future pharmaceutical costs, and studies show it can also improve patient outcomes by reducing drug interactions and by improving the success of treatment. Ultimately those results will translate into a significant reduction in DoD's overall health care costs.

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In FY93 the National Defense Authorization and Appropriations Act, Congress directed DoD to set up a demonstration project to evaluate the use of the mail to provide maintenance-dose pharmaceuticals to eligible beneficiaries. The project's goal was to test customer acceptance of mail service pharmacy and the concept's potential for reducing health care costs and military staffing requirements prior to the establishment of a DoD-wide effort. The Defense Personnel Support Center (DPSC) is contracting with a private sector mail service provider to provide this service. As the contract administrator, DPSC wishes to ensure that it have effective management procedures in place in the following four areas: Validation of customer eligibility; certification of contractor billing; monitoring of customer satisfaction; prevention of the diversion of product, bought at government prices, to commercial customers. This report recommends actions in the above areas that the DPSC should take to effectively manage its mail service contract and it recommends actions that it can take to reduce the cost of mail service pharmacy contracts in the future.					
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